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David M. Eichenlaub
Division of Economics and Finance
State Corporation Commission
1300 East Main Street
Richmond, VA 23219

Re: Comments Concerning the Status of Competition -- Compliance by the State Corporation Commission with § 56-596.B of the Code of Virginia

Dear Mr. Eichenlaub:

Thank you for the opportunity to offer the following comments in response to those of other interested persons. We respond on behalf of the Virginia Committee for Fair Utility Rates and the Old Dominion Committee for Fair Utility Rates (collectively, "the Committees"), which consist of large industrial customers of Dominion Virginia Power ("Virginia Power") and Appalachian Power Company ("Appalachian Power"), respectively.

The Committees' initial comments expressed serious concerns about electric restructuring in Virginia. Such concerns include the fact that customers of both Virginia Power and Appalachian Power will soon face significant, unwarranted rate increases based on an unfair, lopsided process; and, commencing after 2010, when so-called "capped rates" end, customers of both utilities may face extraordinary rate increases, of perhaps 100% or more, that would unfairly enrich both utilities with no corresponding benefit to consumers. The Committees' comments emphasized that states north of Virginia, and, indeed, portions of Virginia itself now are grappling with crushing rate burdens resulting from going to "market" prices for electric supplies. Virginia Power filed comments that largely ignored these concerns, but they address other matters that warrant this brief response.

Claimed Customer Benefits

Virginia Power asserts that restructuring "has produced significant benefits for the Commonwealth's customers." Virginia Power cites "hundreds of millions of dollars" in customer savings resulting from the fuel factor freeze enacted by the General Assembly in 2004. Virginia Power's comments, however, ignore the "hundreds of millions of dollars" in excess revenues that the base, or non-fuel, portion of its "capped rates" has generated and may continue to generate through 2010. As indicated in the Committees' initial comments, Virginia Power had accumulated, according to the Commission Staff's most recent report concerning Virginia Power's earnings (for the year 2003), more than $1.2 billion in earnings available for stranded cost recovery during the 1998 – 2003 period. Virginia Power, however, has yet to incur its first dollar of "stranded costs." The excessive base rates that have produced such excess earnings – rates estimated to be excessive by about $400 million per year for the most recent periods (2002 and 2003) analyzed by the Staff -- are scheduled to remain in effect through 2010. Thus, while the fuel factor freeze, considered alone, has produced since 2004 some customer savings, the Restructuring Act's non-fuel (base) rate provisions have produced significantly excessive non-fuel rates. The adverse impact of the excess base rates on customers may exceed, by a substantial margin, the savings from the fuel rate freeze. Moreover, as Virginia Power's comments acknowledge, the fuel factor freeze is scheduled to end on July 1, 2007, when its fuel factor will be re-set, so any customer savings resulting from the freeze will terminate as of that date. Virginia Power's base rates, however, will not change on that date. Customers, therefore, are scheduled to continue to pay the same base rates that have produced such excessive earnings through 2010.

Virginia Power also claims that consumers have benefited from the "capped rates" on the basis of a study performed in 2002, and later updated in 2004, by Chmura Economics & Analytics ("Chmura"), a Richmond economic consulting firm. Virginia Power hired Chmura to study the impact of "capped rates" on residential utility consumers during the period in which "capped rates" will be in effect. Virginia Power states in its comments that the 2004 study projects residential customer savings of "as much as $1.8 billion through 2010" and "annual savings" for a typical residential customer of "up to $74" during the "capped rate" period.

The Chmura study, however, is based on a macro-economic forecasting model, not Virginia Power's costs. Thus, it ignores the most basic fact of ratemaking: that the Commission sets rates to cover operating costs plus a reasonable return on the utility's investment in assets that provide customers with service. While Virginia Power's cost data during the "capped rate" period, both actual and projected, presumably could have been made available to its own consultant, its consultant proceeded without it. Instead of analyzing Virginia Power's costs in order to determine what its rates would have been if the General Assembly had not enacted the "capped rates," the study estimates what Virginia Power's rates would have been on the basis of factors, such as national employment rates and short-term national interest rates, that have never been the basis for setting Virginia Power's regulated revenue requirement.

The Chmura study's findings, moreover, have been contradicted by detailed annual analyses of Virginia Power's costs and revenues conducted by the Commission Staff. As indicated above, the most recent of those analyses available, which follow the approach used by the Commission in setting rates, show that Virginia Power's "capped rates" have produced revenues significantly in excess of its costs – that is, significantly in excess of the costs that would have been used for ratemaking purposes if its "capped rates" had not been in effect.

Finally, Virginia Power asserts that restructuring "savings" have not been confined to Virginia, and it cites, in particular, studies by two consulting firms, Cambridge Energy Research Associates ("CERA") and Global Energy Decisions, which purport to show significant customers savings nationwide and in the Eastern Interconnect, respectively. As the comments of the Old Dominion Electric Cooperative detail, however, *both* studies contain significant flaws. For example, most of the claimed $34 billion in consumer savings found by the CERA study are ascribed to the southern states, which have experienced little restructuring.

Rate Increases in Non-Restructured States

Virginia Power also contends that rates have increased in non-restructured states, and it cites as examples significant rate increases for utilities in Wisconsin, Oklahoma, and Florida. The Commission and the General Assembly, however, should not be misled by such cases. No one suggests that traditional, cost-based regulation "immune[izes]" customers from legitimate, cost-based rate increases related to a utility's specific circumstances. Thus, customers served by a utility that is heavily dependent upon natural gas, like Public Service Company of Oklahoma (Generation owned by that utility is 74% gas-fired.), will doubtless experience significant rate increases if natural gas prices triple; customers of a utility like Florida Power and Light, which also is heavily dependent upon natural gas-fired generation and which just experienced significant damage due to several massive hurricanes, can expect significant, cost-based rate increases; and customers of utilities in the midst of constructing base load generation (and experiencing increases in fuel and other costs), such as the customers of Wisconsin Public Service Corporation, can expect significant rate increases. Virginia Power's generation fleet, however, is not heavily dependent upon natural gas; its service territory has not experienced anything approaching the level of hurricane-inflicted damage visited upon Florida's utilities; and it is not constructing any new base load generation.

While Virginia Power refers to utilities different from it in important respects as examples of utilities experiencing significant rate increases under traditional regulation, it might have elected to cite an example of such regulation closer to home. North Carolina has not restructured. Virginia Power's North Carolina operations, therefore, are subject to traditional rate regulation in that state. Thus, under North Carolina law, the North Carolina Utilities Commission ("NCUC") may initiate a rate case and, if it finds that a utility's rates are excessive, order a rate reduction. Last year, following such an NCUC-initiated investigation, Virginia Power agreed to a base rate *reduction* of $12 million per year for its North Carolina operations. In contrast, as the Committees' initial comments point out, Virginia's Restructuring Act prohibits the Commission from reducing Virginia Power's base rates.

Increased "Shopping" Elsewhere

Virginia Power cites "fairly vigorous" shopping in several other jurisdictions, especially among larger industrial and commercial users. For example, Virginia Power cites March 2006 data from the Maryland Public Service Commission indicating that competitive providers served

80% of large commercial and industrial accounts. The comments of Constellation Energy make a similar point about high shopping rates among such customers in Maryland.

No one doubts that the expiration of "price caps" in other jurisdictions, and the implementation of market-based rates for large customers, has resulted in increased shopping by large commercial and industrial customers. Obviously, where large users are forced to face significant rate increases (ranging up to 118% in Delaware, for example), as a result of going to market-based default service rates, many large users can be expected to shop to take service from alternative suppliers.

The Committees are concerned, however, about the potentially *extraordinary* rate increases that may result from going to market rates in Virginia and the resulting *windfalls* for Appalachian Power and Virginia Power at their customers' expense. Such "shopping" does not deliver customer benefits if market-based rates are greatly in excess of cost-based, regulated rates for Appalachian Power and Virginia Power. On the contrary, it merely produces unfair and unnecessarily negative economic consequences for millions of customers, including large industrial and commercial customers. The potential for such consequences does not bode well for Virginia's economic future, including the future of jobs in Virginia's manufacturing sector.

Conclusion

We appreciate the opportunity to comment on restructuring issues, and, again, we hope you will take the Committees' concerns into account as you continue to study and assess public policy in this area

Sincerely,

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